



THE UNIVERSITY *of* EDINBURGH

## Edinburgh Research Explorer

### Cautionary tales - the continued development of *Smith v Bank of Scotland*

**Citation for published version:**

Eden, S 2003, 'Cautionary tales - the continued development of *Smith v Bank of Scotland*', *Edinburgh Law Review*, vol. 7, no. 1, pp. 107-118. <https://doi.org/10.3366/elr.2003.7.1.107>

**Digital Object Identifier (DOI):**

[10.3366/elr.2003.7.1.107](https://doi.org/10.3366/elr.2003.7.1.107)

**Link:**

[Link to publication record in Edinburgh Research Explorer](#)

**Document Version:**

Publisher's PDF, also known as Version of record

**Published In:**

Edinburgh Law Review

**Publisher Rights Statement:**

©Eden, S. (2003). Cautionary Tales - the Continued Development of *Smith v Bank of Scotland*. *Edinburgh Law Review*, 7, 107-18doi: 10.3366/elr.2003.7.1.107

**General rights**

Copyright for the publications made accessible via the Edinburgh Research Explorer is retained by the author(s) and / or other copyright owners and it is a condition of accessing these publications that users recognise and abide by the legal requirements associated with these rights.

**Take down policy**

The University of Edinburgh has made every reasonable effort to ensure that Edinburgh Research Explorer content complies with UK legislation. If you believe that the public display of this file breaches copyright please contact [openaccess@ed.ac.uk](mailto:openaccess@ed.ac.uk) providing details, and we will remove access to the work immediately and investigate your claim.



long as the statutory language does not explicitly refer to "living together as a man and wife" or some such comparator. *X v Y* shows it may not be as simple as all that. It will be interesting to see what happens when or if the promised appeal comes to court.

Lilian Edwards  
Senior Lecturer in Law  
University of Edinburgh

EdinLR Vol 7 pp 107–118

## Cautionary Tales—the Continued Development of *Smith v Bank of Scotland*

### A. INTRODUCTION

Only five years have passed since *Smith v Bank of Scotland*<sup>1</sup> in which the House of Lords introduced into Scotland the special protection available to cautionary wives.<sup>2</sup> In this period, there have been several further decisions in Scotland in this area and the House of Lords has also returned to the topic.<sup>3</sup> The first decision of the Inner House, *Clydesdale Bank plc v Black*, provides an opportunity to review Scots law developments and to consider the extent to which there remains a distinctive Scottish approach.

The background to this line of cases is well known. Previously, it was accepted in both jurisdictions that the creditor's rights against the cautioner were not in general affected by the misrepresentations or other wrongful acts of the debtor in relation to the cautioner. Then, in 1994, the House of Lords in *Barclays Bank plc v O'Brien*<sup>4</sup> released a surety wife in England from a guarantee which she had signed on the faith of her husband's misrepre-

1 1997 SC (HL) 111 (henceforth *Smith*). There has been a considerable amount of literature generated by *Smith* and subsequent cases, e.g.: G L Gretton, "Sexually transmitted debt" 1997 SLT (News) 195; G L Gretton, case comment on *Hewitt v Williamson* in 1998 SCLR 616; G L Gretton, "Good News for bankers, bad news for lawyers" 1999 SLT (News) 53; G L Gretton, "Sexually transmitted debt" 1999 TSAR 419; R Dunlop "Smith v Bank of Scotland" [1997] 42 JLS 446; L MacGregor "The House of Lords applies *O'Brien* north of the border" (1998) 2 EdinLR 90; S F Dickson, "Good faith in contract: spousal guarantees and *Smith v Bank of Scotland*" 1998 SLT (News) 39; G J Junor, "The dust settling: *Smith v Bank of Scotland*" 1999 JR 67; A Smith, "Watt v Royal Bank of Scotland: security advice for banks and solicitors: *Smith* reconsidered" 1999 JR 382; M M Siems, "No risk, no fun? Should spouses be advised before committing to guarantees?" [2002] 4 EurRPL 509; R Russell, "*Royal Bank of Scotland v Etridge* No 2: the end of a sorry tale" 2002 SLT (News) 55; M Higgins, "A break from the old routine: the doctrine in *Smith*" 2002 SLT (News) 173. See also H L MacQueen, "Good faith in the Scots law of contract?", and J M Thomson, "Good faith in contracting: a sceptical view", in A D M Forte (ed), *Good Faith in Contract and Property law* (1999) at 5 and 63 respectively.

2 The cases have typically involved wives offering caution in connection with husbands' business borrowing.

3 These are, in the Inner House, *Clydesdale Bank plc v Black* 2002 SLT 764 (henceforth *Black*); in the Outer House, *Thomson v Royal Bank of Scotland plc* 22 May 2002 (henceforth *Thomson*), *Wright v Cotias Investments Inc* 2001 SLT 353 (henceforth *Wright*), *Broadway v Clydesdale Bank plc* 2000 GWD 19–763 (henceforth *Broadway*), *Ahmed v Clydesdale Bank plc* 2001 SLT 423 (henceforth *Ahmed*), *Forsyth v Royal Bank of Scotland plc* 2000 SLT 1295 (henceforth *Forsyth*), *Braithwaite v Royal Bank of Scotland plc* 1999 SLT 25 (henceforth *Braithwaite*); in the Sheriff Court, *Royal Bank of Scotland plc v Wilson* 2001 SLT (Sh Ct) 2 (henceforth *Wilson*), *Royal Bank of Scotland plc v Clark* 2000 SLT (Sh Ct) 101 (henceforth *Clark*). The English House of Lords decision is *Royal Bank of Scotland plc v Etridge (No 2)* [2001] WLR 1021, [2001] UKHL 44 (henceforth *Etridge*). References to the judgments in *Etridge* are to the paragraphs in the UKHL report.

4 [1994] 1 AC 180 (henceforth *O'Brien*).

sentations as to the significance of the deed. On the basis that the policy arguments which persuaded the court in *O'Brien* were equally applicable in Scotland, a similar result was achieved in the House of Lords in *Smith*. Despite seeking to achieve the same end, each jurisdiction followed a different route. In England, the decision was based on the doctrine of "constructive notice", which deems, in certain circumstances, the creditor to know of the wrong committed by the debtor against the surety and to have been a participant in it. In the Scots case, the House of Lords drew upon the doctrine of good faith to impose on the creditor certain duties towards the cautioner.

This area conveniently breaks down into three broad elements, each of which will be considered in turn: (i) the actings of the debtor in relation to the cautioner; (ii) the facts which trigger the creditor's extra obligation towards the cautioner; and (iii) the content of the obligation on the creditor.

## B. THE ACTINGS OF THE DEBTOR

### (1) The relevance of the debtor's wrongful act

One important issue which was not entirely clear following *Smith* was the extent to which the debtor's behaviour should be regarded as relevant. In his comment on *Smith*, Gretton formulated various possible *rationes*. One of these was that the breach of the duty of good faith in itself vitiated the contract of caution without the necessity of establishing any wrongful behaviour by the debtor.<sup>5</sup> Indeed, certain dicta by Lord Clyde in *Smith* might be regarded as supporting this view.<sup>6</sup> The issue was not long in being resolved and, in *Braithwaite*, proof by the pursuer of an actionable wrong by the debtor was regarded as a prerequisite of the cautioner's release. According to Lord Hamilton:<sup>7</sup>

The concept of good faith is used in the sense that a party may not be entitled to enforce his apparent rights because he is aware of or is put on inquiry to discover some prior vitiating factor. The existence in fact of such a factor is a prerequisite to the applicability of that concept.

This position has been confirmed in subsequent cases.<sup>8</sup>

Was this an inevitable result in Scotland? In England, under the doctrine of constructive notice, the wrongful act by the debtor is central. Without the debtor's wrongful act, there is nothing of which the creditor can be deemed to have notice and nothing to give the surety her release. The doctrine of constructive notice requires two steps: the wrong by the debtor; and the creditor having been put on notice of the wrong. This two-transaction approach has been criticised on the basis that there may in fact be no transaction between the debtor and the surety to provide the context of a legal wrong,<sup>9</sup> but it is workable if one imputes either the debtor's behaviour to the creditor, or the creditor's contract to the debtor. In any event, the debtor must have engaged in some form of coercive or misleading behaviour which, had he been in a contractual relationship with the surety, would have been grounds for the surety's release.

5 G L Gretton, "Sexually Transmitted Debt" 1997 SLT (News) 195. He was rather disinclined to support this particular ratio.

6 At 121F Lord Clyde states: "... where the creditor should reasonably suspect that there may be factors bearing on the participation of the cautioner which might undermine the validity of the contract ... the duty [to give the cautioner certain advice] ... would have to be fulfilled if the creditor is not to be prevented from later enforcing the contract".

7 At 33C.

8 E.g. *Wright, Black*.

9 E McKendrick, "Undue influence of English law?", in H L MacQueen (ed), *Scots Law into the 21st Century* (1996), 214.

In Scotland, where the release of the cautioner depends on principles of good faith, it is not obvious that the debtor's actions should be relevant. The development of the doctrine took place in the context of the duty of the creditor to the cautioner. It would appear therefore only one relationship matters: that of the creditor and the cautioner, and the debtor's actions are thus irrelevant. Furthermore, it is accepted that the law of caution is in some respects rather idiosyncratic, containing specialities to protect the cautioner not usually found in other areas of contract law. The actions of the creditor may liberate the cautioner without the cautioner having to show that she has been disadvantaged in any way, as for example in the rule concerning giving time to the debtor.<sup>10</sup> If it is not necessary that the creditor's behaviour should cause any loss to the cautioner in other areas of the law of caution, it can be argued that the same principle should apply to the duties imposed by good faith: it is the creditor's failure which *per se* releases the cautioner, rather than the existence of a loss to which the creditor's failure has contributed.

The relevance of the debtor's wrongful act cannot easily be determined by reference to some *general* notion of good faith, which, in Scotland at least, has proved hard to pin down.<sup>11</sup> It is useful to consider the context in which the principle of good faith expressed in *Smith* was developed, namely as an extension of the creditor's duty not to mislead and to provide disclosure in certain circumstances. Prior to *Smith* the creditor's duty was more or less limited to an obligation to correct manifest misapprehensions and not to mislead by omission.<sup>12</sup> In *Smith* good faith was used to extend the creditor's duty to act not only where misapprehensions were known to be present but also where misapprehensions *might be* present as a result of a *possible* wrongful act by the debtor. Thus, the existence of those misapprehensions and, indirectly, the cause of the misapprehensions, remain central to the content of the duty of good faith. And of course, the application of the doctrine would be significantly extended in scope if it permitted a person to escape from an obligation which he or she undertook with full understanding of the consequences. Accordingly, to link the doctrine to the existence of defective consent would appear to be a sensible development.

## (2) Must the lack of good faith cause the defective consent?

At least one question remains unanswered by the above discussion. This is whether a causal relationship must exist between the lack of good faith and the impaired consent. Consider the following situation. The creditor fails to give any warnings or advice whatsoever to the cautioner. Unknown to the creditor, the cautioner receives legal advice, although the advice fails to counteract the effect of the debtor's misrepresentations. So, we have a breach of the duty by the creditor and impaired consent caused by the wrongful act of the debtor, but the creditor can reasonably claim that, had it fulfilled its duty by recommending independent advice, the failure of consent would not have been remedied.

The only case which sheds light in this is *Broadway*, a case in which the lenders sought to rely on the apparent evidence that the security granter was receiving legal advice. According to Lord Macfadyen, when it is determined whether the lenders acted in good faith, "(t)he issue is not, of course, whether the pursuer in fact had a solicitor acting for her, but rather whether the defenders knew or had reasonable ground for believing that she did".<sup>13</sup> Although one should not place too much reliance on an isolated sentence in a judgment, this does

10 W M Gloag and J M Irvine, *Rights in Security and Cautionary Obligations* (1897) 865–866.

11 MacQueen, "Good faith in the Scots law of contract?", and Thomson "Good faith in contracting: a sceptical view", both note 1 above.

12 *Royal Bank of Scotland v Greenshields* 1914 SC 259.

13 At para 45. In fact, because he was of the view that the lenders were imputed with the knowledge of the solicitors through the law of agency, they would be in good faith on this account anyway. This view may not be correct: see the discussion below at D(3).

suggest that the issue of good faith is still relevant even where the cautioner received legal advice. This in turn means that it does not matter whether or not the fulfilment of the duty of good faith would have prevented any defect of consent. Of course, the defective consent must still be proved, but if the statement of Lord Macfadyen above accurately reflects the position, no causal relationship between failure of duty and lack of consent induced by the wrongful act of the debtor need be established.

It is generally the case that a breach of a legal duty renders a person liable only for loss caused by that breach so the question is whether a breach of the duty of good faith should depart from that general principle. Of course, in the present context, the breach of the duty of good faith does not cause the loss but rather makes it more likely that the other party will contract with defective consent. Thus the question here is not whether the breach caused the defective consent but whether, if the breach had not occurred, the defect in consent would have been remedied.

To require the cautioner to establish the causal link would be to place on her a heavy burden of proof: she would be required to prove that *if* she had received a warning from the creditor and *if* she had followed it up with independent legal advice, she would not have granted the security. This would undermine the protection of *Smith* and has not been the approach in the cases so far. However, if the evidential burden were placed on the creditor to establish that it would have made no difference had it fulfilled its duty, this would provide protection to cautioners while removing the anomaly of holding a party responsible for a loss which it did not cause. We have already noted that the breach of the duty of good faith by the creditor on its own does not release the cautioner: there must also be a lack of consent caused by the wrongful act of another. The natural explanation for requiring both these elements to be present is that there is a connection between them, and it is suggested that a lack of causal connection should be a relevant defence to a creditor.

### (3) The nature of the debtor's actions

There has been little analysis so far as to the nature of the debtor's, as opposed to the creditor's, actions. In *Braithwaite* Lord Hamilton referred with evident approval to Lord Browne-Wilkinson's reference in *O'Brien* to an "actionable wrong" perpetrated by the debtor.<sup>14</sup> Misrepresentation has been the most commonly averred wrongful conduct,<sup>15</sup> but allegations of undue influence have sometimes been made,<sup>16</sup> and facility and circumvention is also a relevant defence.<sup>17</sup>

It would appear that the nature of the debtor's actions must have compromised the consent of the cautioner to the extent that, had the contract been between the debtor and the cautioner, the obligation would have been rendered voidable: the cautioner must show that, had it not been for the undue influence or misrepresentation, etc, she would not have entered into the transaction.<sup>18</sup> The *Smith* principle does not apply to obligations which are void rather than voidable: such obligations are flawed without any failure of good faith.<sup>19</sup>

Where the misrepresentation is fraudulent, the cautioner may not have to rely on *Smith* and show a breach of a duty by the creditor, as the rule in *Clydesdale Bank v Paul* may apply:<sup>20</sup> this is that a person may not benefit from the fraud of another unless he or she is

14 At 33, referring to Lord Browne-Wilkinson's remarks in *O'Brien* at 197.

15 *Smith, Forsyth, Braithwaite, Clark*.

16 *Broadway, Thomson, Black*.

17 *Wright*.

18 *Broadway* at para 31.

19 *Smith* per Lord Clyde at 117 D-E where the example of a contract induced by extortion or force and fear was given. Another example might be essential error: *Harrison v Butters* 1969 SLT 183.

20 (1877) 4 R 626.

both innocent of the fraud and has given some valuable consideration.<sup>21</sup> However, this rule offers scant protection to cautioners, since most lenders are innocent of fraud perpetrated by debtors, and they have usually lent money on the basis of the cautionary obligation, thereby giving valuable consideration. Thus the principle in *Clydesdale Bank v Paul* applies only where there is complicity in fraud or where caution is granted for an principal obligation which has already been undertaken.

#### (4) Undue influence

There has been some discussion in recent cases as to the existence of presumptions in relation to undue influence, and the effect, if any, of the English cases on the development of the substantive law in Scotland. As an import from England, undue influence in Scotland is particularly susceptible to arguments based on English law.

Given the personal nature of the relationships in which undue influence can arise, proof of such influence can be difficult, which means that evidential presumptions are extremely important. Immediately following *O'Brien* there was uncertainty as to whether English law operated a presumption of undue influence in relations between husband and wife. This was clarified by *Etridge* to the effect that there is no presumption of undue influence. However, if a wife can show that she has placed trust and confidence in her husband in the management of the family finances, and the transaction she entered into is so plainly to her disadvantage that it was not explicable without the presence of some wrong perpetrated by her husband, the evidential burden then shifts to the lender.<sup>22</sup> The simple fact that one spouse grants a security over her share of the matrimonial home in order to secure the other spouse's debt is not on its own inexplicable, however, and does not shift the burden of proof.

Similarly in Scotland there is no presumption of undue influence in spousal relationships,<sup>23</sup> but the issue of when, if at all, the burden of proof shifts to the creditor is not as clearly set out as in England. The view was expressed in *O'Brien*<sup>24</sup> that a combination of (i) a relationship of trust and confidence, and (ii) a result manifestly disadvantageous to the party would give rise to a presumption of undue influence. This view was rejected in *Broadway* as being too structured.<sup>25</sup> However, whilst there is recognition that the role of presumptions in English law might be greater and more defined, there is also support for the view that the burden of proof shifts. The following extract from *Honeyman's Exrs v Sharp*<sup>26</sup> has been quoted with approval in both *Smith*<sup>27</sup> and *Thomson*:<sup>28</sup>

[T]here must be cases where the facts as proved raise a *prima facie* inference that a gift has been acquired by abuse of a position of trust and which at least cry out for an explanation even though the precise mode of abuse is not known and might indeed be too subtle to be readily capable of precise expression.

So although the position in Scotland has been expressed in rather less formulaic terms than in England, there would appear to be little distinction in practice between an "inexplicable" transaction in England and facts which "cry out for an explanation" in Scotland, both of which appear to shift the burden of proof on to the creditor.

21 This is the rule in *Scholefield v Templar* (1859) 28 Ch 452, referred to by Lord Clyde in *Smith* at 117C–D.

22 Lord Nichols at para 14.

23 *Smith* at 120C.

24 Per Lord Browne-Wilkinson at 189.

25 At para 27.

26 1978 SC 223 per Lord Maxwell at 230.

27 Per Lord Clyde at 119G–H.

28 Per Lord Clarke at para 10.

It is important that separate consideration is accorded to the circumstances which give rise to a duty, and the circumstances which amount to the wrongdoing by the debtor. The fact that particular circumstances give rise to a duty on the creditor's part<sup>29</sup> does not mean that a presumption of undue influence also arises. The distinction was expressed by Lord Clyde in *Smith* as follows:<sup>30</sup>

It is not to be supposed or presumed that simply because there is a close personal relationship the security will be given otherwise than with a full and free consent . . . But to require the creditor to take some initiative where the circumstances of the case may reasonably seem to give rise to the risk that the cautioner's consent is not full and free does not necessarily create as a matter of the law of evidence any presumption in the proving of any ground for reduction.

Despite its parentage, the law of undue influence is firmly located within the Scottish authorities, according to Lord Clarke in *Thomson*,<sup>31</sup> where averments of abuse of the trust and confidence arising in a marriage by a failure of explanation and lack of candour were found to give rise to a relevant case. The essence of undue influence is "an abuse of a relationship and confidence",<sup>32</sup> whether it benefits the person exerting the influence or simply helps achieve an end which he regards as desirable.<sup>33</sup> It has also been noted that a court should be slow to dismiss a case on undue influence on the basis of a lack of relevancy without allowing the case to go to proof.<sup>34</sup>

### C. WHEN IS THE CREDITOR UNDER A DUTY OF CARE?

#### (1) General considerations

The starting point remains Lord Clyde's statement in *Smith* to the effect that a duty arises:<sup>35</sup>

. . . if the circumstances of the case are such as to lead a reasonable man to believe that owing to the personal relationship between the debtor and the proposed cautioner the latter's consent may not be fully informed or freely given. Of course if the creditor, acting honestly and in good faith, has no reason to believe that there is any particularly close relationship between the debtor and the proposed cautioner the duty will not arise.

Lord Clyde added that he thought it unwise to attempt a more precise formulation.<sup>36</sup> Most of the decisions since *Smith* have concerned spouses and it has been readily accepted that the creditor is under a duty in such a case. The only case in which an issue has arisen as to whether the circumstances of the case gave rise to the risk is *Wright*, in which the relationship between the debtor and the cautioner was complex. The cautioner was a director and 50% shareholder of the debtor company. It was the view of Lord Macfadyen that this would not on its own have been sufficient to give rise to any duty on the creditor. However, there were further complications. The company had been created in order to try to save a business operated by the elderly cautioner's son, which had run into serious financial trouble. The cautioner was already personally liable for, and had granted heritable securities in support

29 Discussed in section C below.

30 Per Lord Clyde at 120G–H.

31 Here a security was granted over the wife's share of the home in support of a business loan to her husband's company. The following averments did not give rise to a *presumption* of undue influence, but formed a relevant case: that she relied on the defender to make financial arrangements; that the defender never discussed his business with the pursuer; and that he failed to advise her as to the effect of what she signed.

32 *Broadway* per Lord Macfadyen at para 26.

33 *Broadway* per Lord Macfadyen at para 28.

34 *Black* per Lord Coulsfield at 767, and Lord Marnoch at 772. Cf Lord Sutherland at 776.

35 At 121–122.

36 He reiterated this view in *Etridge* at para 92.

of, considerable debts run up by the business. These debts were paid off by a loan to the new company and secured by a further heritable security granted by the cautioner, the subject of the present action. The son was to be employed by the company.

It seems likely that the court would have been prepared to find that there was a duty on the creditor as a result of the mother/son relationship, even though the principal debtor was a company and not the son. According to Lord Macfadyen in *Wright*:<sup>37</sup>

The rule can apply even in circumstances where the person who is in a close personal relationship with the cautioner is not himself the borrower, provided he had an interest to use the personal relationship to prevail on the cautioner to agree to act as such, and the existence of the relationship is known to the creditor.

So a cautioner who grants security for a company with which a relative is closely connected or a partnership of which a relative is a partner would be brought within the principle. Furthermore, the court did not rule out the possibility of the principle applying, even though the cautioner became a shareholder and director of the company as part of the rescue package, provided the pre-existing debt had been owed by the son or his business. It would appear that the key factor which led in this case to the finding that no duty was owed to the cautioner was the fact that she had a significant interest in the loan which was made. Presumably, although not expressly articulated, a cautioner's consent is more likely to be genuine where her own interests are also served, and so a reduced risk of impaired consent in turn reduces the duty of good faith.

It is not entirely clear in *Wright* that the cautioner's interests were served by the simple fact that the loan was used to pay off her pre-existing debts. All that had happened was that a new, bigger loan replaced a smaller pre-existing loan and she was under an increased liability. Perhaps a more important factor was that the pre-existing debts meant that she already stood to lose a considerable amount of money if the business failed and she therefore had a strong interest in its continued existence, which was the point of the restructuring exercise.

In England, the combination of two factors in *O'Brien* was held to give rise to a duty on the creditors, namely where:<sup>38</sup>

a) the transaction is not on its face to the financial advantage of the wife; and b) there is a substantial risk in transactions of that kind that, in procuring the wife to act as surety, the husband has committed a legal or equitable wrong.

Subsequently, the Court of Appeal in *Etridge* interpreted this restrictively and implied a duty only where the bank had particular knowledge of the affairs of the parties and the degree of trust placed by the wife in the husband. On this point the House of Lords disagreed and a low threshold was substituted: a bank is "put on enquiry in every case where the relationship between the surety and the debtor is non-commercial".<sup>39</sup> This might appear a remarkable extension to the range of situations in which a lender should be put on inquiry, although perhaps, on reflection, not so radical in practice. It is unlikely that any individual would gratuitously provide security for the debts of another without the existence of a close personal relationship, except where he or she stood to gain commercially. In any event, the present practice of the banks is to put into effect anti-*O'Brien* procedures whenever the person providing security is an individual rather than a business or a company, including the situation where a director is to provide security for a company.<sup>40</sup>

<sup>37</sup> At 335C.

<sup>38</sup> Lord Browne-Wilkinson in *O'Brien* at 196.

<sup>39</sup> Per Lord Nicholls at para 89. See also Lord Hobhouse at paras 108–109.

<sup>40</sup> Current *Banking Code*, para 11.2 (January 2001); and *Business Banking Code*, para 11.3 (March 2002) (available at <http://www.bankingcode.org.uk/>).



## (2) "All sums due" securities

In contrast to the developments above, which have been informed by concepts of fairness and reasonable behaviour, the decision in *Ahmed* stands out in its strict legal approach. The facts were simple. The pursuer, along with her husband, entered into a personal obligation and a standard security for all sums due either by herself or her husband. The initial loan was to finance the purchase of the house over which the security was granted. Subsequently the husband took a business loan from the lenders. The case report does not reveal if the pursuer was aware of this or whether she was consulted by the bank. A few years later the bank wrote to the pursuer asking her to become a guarantor of her husband's debts. She refused. The bank then, without the knowledge of the pursuer, entered into an arrangement with the husband by which his business debts were restructured. By virtue of the original security and personal obligation the pursuer was liable for these debts.

The case was clearly distinguishable from *Smith* as, at the time the security was entered into (i) there was no misrepresentation by the husband; (ii) the pleadings revealed no defective consent; and (iii) she was in receipt of legal advice. The pursuer's condescendence that the bank should have warned her from the outset of the possibility of further loans being made was abandoned by counsel, possibly because she was then in receipt of legal advice. This effectively closed the door on the argument that the bank were in bad faith at the time when the agreement was entered into. Mrs Ahmed's case appears to have been that by inviting her to become guarantor for her husband, the bank were misrepresenting to her that if she did not sign a guarantee, she would not be liable, and this put them in bad faith. She failed on the basis that this was an unsound deployment of the principle of good faith in the light of the earlier cases.

A lender who makes advances to B without the consent of A on the basis of an earlier security, entered into by A and B for another purpose entirely, is at least engaged in extremely questionable practice. It may also be in breach of the current code of banking practice which explicitly states that open ended guarantees will not be taken.<sup>41</sup> "All sums due" securities are effectively unlimited guarantees if the banks operate them as they did in *Ahmed*. Although an argument based on the absence of good faith on the *creation* of the contract would have failed, a case could perhaps have been made on the basis of an absence of good faith in the *performance* of the contract. This would significantly extend the scope of *Smith* and it must be admitted that the prospect of success of such an argument might be slight. However, although authority for the existence of a duty of good faith in performance is limited, it is not entirely lacking under Scots law. For example, discretionary powers under a contract are required to be exercised reasonably, effectively operating some concept of good faith in the performance of the contract.<sup>42</sup> This argument would have provided an opportunity to test the extent of a general concept of good faith in Scots contract law.

One thing is clear. If lenders on all sums due securities are likely to be protected by the fact that the borrowers are in receipt of legal advice, the cautioner's best chance lies in an action against her solicitor. Solicitors should be extremely careful in giving and recording advice to clients who jointly enter into an "all sums due" security, and potentially this affects a far larger group in Scotland than that affected by *Smith*.

## D. THE DUTY OF GOOD FAITH

### (1) General considerations

The Scottish judges, consistently with the amorphous nature of good faith, have avoided a prescriptive approach to the steps which should be taken by lenders or solicitors, in contrast

41 The *Banking Code* (note 40 above) states simply at para 11.2: "We will not take an unlimited guarantee."

42 E.g. *Gordon District Council v Wimpey Homes Holdings Ltd* 1989 SLT 141; *Scottish Tourist Board v Dean Park Ltd* 1998 SLT 1121.

to their English counterparts.<sup>43</sup> *Black* is particularly significant in this context, coming as it did after *Etridge* in which a detailed account of the duties of the creditor and the cautioner's solicitor was given by the House of Lords.

The starting point in Scotland is, as before, Lord Clyde's statement in *Smith* that: "it would be sufficient for the creditor to warn the potential cautioner of the consequences of entering into the proposed cautionary obligation and to advise him or her to take independent advice".<sup>44</sup>

What form do the warnings and advice require to take? Is it sufficient if the warnings and advice are given as part of the security document? What if the lender knows that, despite its suggestion, the cautioner has not obtained legal advice?

The answer would appear to be that it is acceptable for the warnings and advice to be contained in the guarantee without further ado; there is no duty to investigate. Although in *Black* the lender's solicitors also wrote to the cautioner suggesting legal advice, it appears that the warnings in the guarantee itself were sufficient to discharge the duty of the lenders. Lord Sutherland maintained:

I do not consider that any inference can be drawn from what Lord Clyde said either in *Smith* or in *Etridge* that he was of the opinion that in Scotland there was or should be a duty to investigate how far the written warnings and advice had been seen, understood and followed up by a guarantor and thereby "satisfy" themselves that all was well.<sup>45</sup>

It has to be said that this offers very little in the way of protection to the cautioner. There is a suggestion in *Etridge* that the lenders should refuse to make the loan if the cautioner does not take legal advice.<sup>46</sup> However, it is likely that the Scots approach would be more pragmatic and the court would consider all the circumstances of the case in judging whether the lender could assert its continued good faith in the knowledge of the cautioner's omission.

It is clear that the duty on the lender is not to ensure that the cautioner actually understands, but to take reasonable steps to ensure that she understands. In the aftermath of *O'Brien* and *Smith* the practice of the banks was to advise potential guarantors to take legal advice rather than giving advice themselves, and much of the subsequent case-law has been concerned with the extent that the receipt of independent legal advice by the cautioner lets a lender off the hook.

As long as the lender has reasonable grounds to believe that the cautioner is receiving legal advice, it seems that Scots law requires no further steps to be taken and it does not matter whether the solicitors are also acting for the bank or for the debtor.<sup>47</sup> In *Forsyth*, the bank instructed the husband's solicitors to act on its behalf in the preparation of the security and the solicitors gave the appearance, in communications with the bank, that they were also acting for the wife. The bank had not instructed the solicitors to act for the wife but had reasonably assumed that she was receiving advice from them. On behalf of the wife it was argued that, given the manifest potential for conflict of interest, the duty of good faith meant that the bank could not simply make such an assumption but should have enquired into the position. However, the court held that to advise a person to take advice when it appeared

43 Per Lord Clyde in *Smith* at 122, and *Etridge* at para 95; Lord Coulsfield in *Black* at 771E-F; Lord Marnoch at 773B.

44 At 122C.

45 At 776H. See also Lord Marnoch at 772-773. Lord Coulsfield was less forceful on this point, although of the view that it was sufficient to establish good faith by reference to practice at the time the obligation was entered into, which was before the House of Lords decided *Smith*.

46 Lord Nicholl at para 79.

47 See *Forsyth*, *Wright*, and *Clark*. The decision in *Forsyth* appears to have been approved by Lord Clyde in *Etridge* (at para 95), although his English brethren would not have approved.

that she was already advised would be to replicate what it could be assumed had already been done by the solicitor. Although there may be circumstances where, given the creditor's special knowledge, it is not entitled to rely on the fact that solicitors appear to be advising the cautioner,<sup>48</sup> in the normal course of events a bank is entitled to assume that a solicitor will fulfil his or her professional duties and will act in accordance with the rules of professional practice. In the event of a conflict of interest between the borrower and the person granting security, the creditor can assume that the solicitors would have advised the wife to seek advice from another firm in accordance with the Solicitors Practice Rules.<sup>49</sup> Moreover, Lord Macfadyen's judgment in *Forsyth* cites English authority to the effect that the solicitors' profession is to be regarded as an "honourable" and "competent" one which "oils the wheels of business",<sup>50</sup> although while the duties of the honourable, competent profession in England have been set out in some detail in *Etridge*,<sup>51</sup> the Scots cases have so far been silent on this issue.

As in Scotland, in England neither the lenders nor the solicitors advising sureties have to satisfy themselves that the surety's consent is truly given, as this would lead to intolerable inquisition.<sup>52</sup> However, instead of the Scots duty to advise or to suggest legal advice, in England the duty is to "bring home" to the surety the nature of the transaction and to "satisfy" itself that the surety has been properly advised.<sup>53</sup> The lender cannot simply advise the surety to get independent legal advice but now must follow detailed steps laid out by Lord Nicholls and Lord Scott. This approach, one might note, did not find favour with Lord Clyde who would have preferred something less prescriptive.<sup>54</sup> According to Lord Nicholls,<sup>55</sup> the lender must, in respect of transactions entered into post-*Etridge*, follow a three-stage process: (i) it must ask the surety to nominate a solicitor; (ii) it must, with the consent of the debtor, provide the solicitor with sufficient financial information to enable proper advice to be given; and (iii) it must receive confirmation from the solicitor that he or she has so advised the surety. Even these steps will not protect the bank if it knows or has reason to suspect that the solicitor has not given the surety a proper explanation. In such a case, further steps as appropriate must be taken by the bank. The duty in England, then, is much more onerous than in Scotland where it appears that a warning in a pre-printed form will suffice.

## (2) At which point should the content of the duty of good faith be tested?

Should the actions of the lender be tested by reference to practice current at the time the cautionary obligation was entered into, or at the time of the hearing (if this is different)? The majority in *Etridge* clearly intended the steps laid out above to be the standard for post-*Etridge* agreements.<sup>56</sup> In Scotland, the Inner House in *Black* was not at one on this issue. Lords Coulsfield and Sutherland were of the view that, because *Smith* expressly changed the law, good faith had to be judged by the practice prevalent at the time. Lord Marnoch demurred in this view. This may be of little practical importance, as a bank which was acting in accordance with banking practice even pre-*Smith* was already fulfilling the obligations placed upon it by *Smith*.

48 The pursuer ran an unsuccessful argument on this point in *Wright*.

49 Solicitors (Scotland) Practice Rules 1986, rules 3, 5 and 7.

50 At 1298 citing *Bank of Baroda v Rayarel* [1995] 2 FLR 376 per Hirst LJ at 383.

51 At paras 64–68; 168–170.

52 In contrast to the Court of Appeal in *Etridge* [1998] 4 All ER 705.

53 Whether the differences reflect a different underlying duty caused Lord Coulsfield some anxiety in *Black* at 771G.

54 At para 95.

55 At para 79. See also Lord Scott at para 68, and Lord Hobhouse at para 116.

56 Lord Nicholls at para 80, although he thought that a bank should require confirmation from the solicitor even in a pre-*Etridge* agreement.

### (3) The solicitor as agent of the creditor

If the lender reasonably, but erroneously, believes that the cautioner has received independent legal advice, can the knowledge of the solicitors be attributed to the lender on the basis of the law of agency where the solicitor in question is also acting for the lender? This potentially important curtailment of the defence of reasonable belief has been considered in two cases in Scotland. In *Broadway*, the lender argued that the fact that the solicitor acting for the lender also believed himself to be acting for the cautioner put the lender in good faith. Although there was some question about the capacity in which a solicitor held knowledge, it was thought that whether or not he acted for the cautioner was the type of information which the solicitor was permitted to have in his capacity as solicitor for the lender. Thus, although a decision on this point was unnecessary for the disposal of the case, Lord Macfadyen was inclined towards the view that the knowledge of the solicitor could indeed be attributed to the lender in order to establish good faith. This was subject to the caveat that not all information such a solicitor acquired could be imputed to the lender: it would depend on whether it was information which he must "withhold from himself in his other capacity".<sup>57</sup>

In *Thomson*, judgment was reserved on the soundness of this view. The cautioner argued that the lender should be imputed with the knowledge of the solicitor that he was *not* acting for the cautioner. Lord Clarke distinguished *Broadway* on factual grounds and thought that the misrepresentation of the agent as to his clients was not knowledge which should be so imputed. Lord Clarke also distinguished certain dicta in *Etridge* which suggested that the knowledge of a solicitor acting for the lender is attributable to the lender, partly on the basis that the doctrine of constructive notice operates with different effect from the law of agency, and partly because *Etridge* turned on the specific provisions of English legislation. This is likely to be an area to which the courts will return.

## E. CONCLUSION

### (1) Has the general doctrine of good faith in contract law developed since *Smith*?

The short answer is no. Although the doctrine was developed out of the duty of good faith which applies in cautionary obligations, it was never restricted to cautionary obligations properly so-called and has, from the start, been applied without distinction to real securities granted for the debt of another, whether or not the cautioner was in addition personally liable.<sup>58</sup> However, despite the references in *Smith* to the general duty of good faith in contract law, so far this duty has not been applied in situations beyond the original context.<sup>59</sup>

### (2) Are the paths in England and Scotland diverging?

A comparison between the judgments of Lord Browne-Wilkinson in *O'Brien* and Lord Clyde in *Smith* reveals differences extending beyond distinctive legal justifications for what was essentially the same policy decision. It also reveals different approaches: one specific, pragmatic and precedent based, the second principled, less formulaic and less certain, especially in the context of the duties on the banks.

The Scots judges have inevitably been required to consider extensive citation of English authority by counsel and lengthy extracts from the English cases are frequently found. On the whole, the approach has been to take the English cases into consideration whilst asserting the differences between the origins of the doctrines. However, the judgments of the Inner House in *Black* most noticeably contain virtually no quotations from English cases, with the

<sup>57</sup> At 47.

<sup>58</sup> The term "cautionary obligation" in Scotland applies to a personal obligation only. In England, the equivalent term "suretyship" is rather wider and includes the grant of a security for the debt of another.

<sup>59</sup> *Ahmed*, discussed above at C(2), might be regarded as an opportunity lost in this regard.

exception of Lord Clyde's judgment in *Etridge*. Otherwise the court appears consciously to distance itself from English authority. Lord Sutherland, for example, expressly states that he believes harmonisation is desirable only where it involves no departure from principles of Scots law.<sup>60</sup>

When divergence is tested against results rather than statements, a degree of similarity emerges. Some facets of the doctrines appear to be identical, in particular the nature and effect of the wrong by the debtor.<sup>61</sup> Others are very similar, despite different formulations, for example the operation of presumptions in undue influence.<sup>62</sup> Others sound rather different but in practice these differences probably do not add up to much, for example the scope of the creditor's duty.<sup>63</sup> The most evident divergence between jurisdictions is in relation to the detailed obligations on the banks, which are significantly more extensive in England, in particular the obligation to make financial information available to the advising solicitor.<sup>64</sup> Although Lord Coulsfield and his brethren rejected the detailed approach of the English, he was less certain that there did not remain some identity in the underlying tests as to the presence of good faith and the absence of constructive notice. It is suggested that the decision in *Black* speaks for itself, and is indeed evidence of an underlying difference. It signifies an emphatic confirmation of the continued separate development of the doctrine in Scotland, although the practical effect should not be overstated.

Sandra Eden

Senior Lecturer in Law  
University of Edinburgh

*(The author thanks George Gretton and Laura Macgregor for reading and commenting on an earlier version of this article. Any errors are hers alone.)*

60 At 775I. See also Lord Marnoch at 773H.

61 See Section B(1).

62 See Section B(4).

63 See Section C(1)

64 The existence of such a duty is specifically rejected in *Black* per Lord Marnoch at 774G.

EdinLR Vol 7 pp 118–123

## Bridging the Care Gap: *Robertson v Fife Council* and Paying for Residential Care

### A. INTRODUCTION

Demographics indicate that personal care of the elderly in residential accommodation is an expensive and growing problem. It has been a flagship policy of the first Scottish administration that such personal care is to be provided in Scotland free of charge to the recipient, irrespective of that recipient's means.<sup>1</sup> This policy derives from the recommendations of the Sutherland Commission, which were for the whole of the United Kingdom,<sup>2</sup> although the Commission's

1 A simple search of any of the records of the Scottish newspapers for the last few years reveals scores of articles on the subject. More official cheerleading can be found in the many Scottish Executive Press releases on the subject, culminating in that of 1 July 2002, "Free personal care now on stream" (at <http://www.scotland.gov.uk/pages/news/2002/07/SENW052.aspx>).

2 The Royal Commission on Long Term Care, chaired by Sir Stewart Sutherland (then principal of the University of Edinburgh), presented its final report entitled *With Respect to Old Age: Long Term Care—Rights and Responsibilities* (Cm 4192:1999) in March 1999. It included as its first recommendation: "The